INDEX

	Page
Statement	2
Discussion	11
Conclusion	15

CITATIONS

Cases:

Permian Basin Area Rate Cases, 390 U.S. 747 — 3, 6

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 — 2

Southern Louisiana Area Rate Cases, 428 F. 2d 407, on rehearing, 444 F. 2d 125, certiorari denied, 400 U.S. 950 — 3, 4–5

Southern Louisiana I (Op. No. 546), 40 FPC 530 — 3–4, 5, 6, 8, 11

Southern Louisiana II, (Op. Nos. 598, 598A), 46 FPC 86, 633 — 5–6, 7, 8, 12

Texas Gulf Coast Area Natural Gas Rate Cases, C.A.D.C., Nos. 71–1828, *et al.*, decided August 24, 1973, pending on petitions for writs of certiorari, Nos. 73–966, 73–967, 73–968, 73–969 — 12, 13, 15

Statutes:

Natural Gas Act, 52 Stat. 821, *et seq.*, as amended, 15 U.S.C. 717, *et seq.*:

Section 4, 15 U.S.C. 717c — 2

Section 5, 15 U.S.C. 717d — 2

529-489—73——1

In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-437

MOBIL OIL CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION

No. 73-457

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

v.

FEDERAL POWER COMMISSION

No. 73-464

MUNICIPAL DISTRIBUTORS GROUP, PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE FEDERAL POWER COMMISSION

These cases involve the validity under the Natural Gas Act of the Federal Power Commission's order fixing just and reasonable rates for the interstate sale

of natural gas by independent producers in the Southern Louisiana producing area. The court of appeals upheld the order, and we think the decision is in all respects correct. For the reasons stated in this memorandum, however, we believe it would be appropriate for this Court to grant the petitions and set the cases for oral argument.

STATEMENT

1. BACKGROUND

In 1954, this Court held in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672, that the Federal Power Commission has jurisdiction under the Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.,* to regulate well-head sales by producers of natural gas to interstate pipelines. All rates and charges for such sales were thus required under Section 4(a) of the Act, 15 U.S.C. 717c(a), to be "just and reasonable." The Commission is empowered, under Sections 4 and 5, 15 U.S.C. 717c and 717d, to inquire into the lawfulness of any rate and, in the event it finds a rate unlawful, to determine and prescribe the just and reasonable rate.

For six years following the decision in *Phillips,* the Commission endeavored to regulate the sales of some 2,500 producers by the traditional method of examining each company's costs of service. This process, however, proved administratively unworkable. In 1960, the Commission abandoned the company-by-company approach and undertook instead to determine maximum just and reasonable producers' rates

for each of the major gas producing areas. Its authority to set area-wide maximum rates was upheld by this Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747.

In an area proceeding, the Commission considers the costs of service of all the producers in the area, rather than of each producer separately, and it establishes a ceiling on rates that applies to all sales in the area. In setting the area rate structure, however, the Commission does not look solely to the producers' costs of service. As this Court stated in *Permian, supra,* "[t]he Commission cannot confine its inquiries * * * to the computation of costs of service" (390 U.S. at 791). It must, in addition, consider the effect of rates on the future supply of natural gas. "[P]rice can meaningfully be employed by the Commission to encourage exploration and production" (*id.* at 797).

2. SOLA I

There have been two stages to the administrative proceedings in the present case. On May 10, 1961, the Commission instituted a proceeding ("*SoLa I*") to establish just and reasonable rates for producer sales in the Southern Louisiana area.[1] After extensive hear-

[1] The Southern Louisiana area consists of the southern portion of the State of Louisiana and the state and federal areas of the Gulf of Mexico off the Louisiana coast. The area accounts for about one-third of the Nation's domestic gas production, and has been called "the most important gas-producing area in the country." *Southern Louisiana Area Rate Cases*, 428 F. 2d 407, 418 (C.A. 5), on rehearing, 444 F. 2d 125, certiorari denied, 400 U.S. 950.

ings, the Commission, on September 25, 1968, issued Opinion No. 546 and an accompanying order (40 FPC 530) establishing ceiling rates for gas sold by producers in the area and ordering refunds of rates in excess of the maximum that had been collected by producers prior to the issuance of the Commission's order.

The court of appeals upheld the order. *Southern Louisiana Area Rate Cases,* 428 F. 2d 407 (C.A. 5). It expressed the view, however, that the Commission should give more attention in ratemaking to non-cost factors in order to encourage exploration and assure an adequate supply of natural gas for the future (428 F. 2d at 441–444). The court therefore specified that its affirmance of the Commission's order "should not * * * be interpreted to interfere with Commission action that would change the rates we have approved here" (*id.* at 444–445). The court was aware that the Commission had already "instituted new proceedings to reconsider all major actions it had taken in the orders before us" and "is now holding hearings that will probably result in substantial modifications of the rates set in this case" (*id.* at 421). Indeed, "the existence of the new proceedings * * * has been one of the factors we have considered in deciding to affirm the Commission's decisions" (*id.* at 445).

In response to petitions for rehearing urging that the Commission's authority to modify its order could be exercised only prospectively, the court stated (444 F. 2d 125, 126–127):

> We wish to make crystal clear the authority of the Commission in this case to reopen *any*

> part of its order that circumstances require be reopened. Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so.

With respect to the refunds provided for in the Commission's order, the court stated that if "the refunds are too burdensome in light of new evidence * * * the Commission shall have the power and the duty to remedy the situation by changing its orders" (*id.* at 127).

This Court denied certiorari (400 U.S. 950).

3. SOLA II

The new proceeding to which the court of appeals referred (*"SoLa II"*) was originally limited to the offshore federal domain portion of the Southern Louisiana area (C.A. App. 2–11)[2] but was expanded, while *SoLa I* was pending in the court of appeals, to include the entire area and virtually all the issues that had been decided in *SoLa I* (*id.* at 73–80). On December 24, 1970, the Commission reopened *SoLa I,* ordered it consolidated with *SoLa II,* and directed

[2] "C.A. App." refers to Part I of the joint appendix in the court of appeals, copies of which were filed by petitioner in No. 73–437 together with its petition.

that a settlement proposal, which had emerged from a conference convened by the Presiding Examiner and which was supported by most of the parties to the proceeding, be made part of the record of the consolidated proceeding (*id.* at 352–354). On July 16, 1971, the Commission issued Opinion No. 598 and an accompanying order (*id.* at 559–750), establishing a new rate structure for the Southern Louisiana area superseding the one established in *SoLa I*.

The rate structure was designed to alleviate an increasingly critical gas supply shortage while maintaining reasonable prices (see *id.* at 601–614). It has two central features: base area ceiling rates and a system of incentives. The base rates vary from 21.375 cents to 26 cents per Mcf (thousand cubic feet) according to the "vintage" of the gas (*i.e.*, the date of the contract under which it is delivered)[3] and according to whether it is "onshore" (subject to the Louisiana production tax) or offshore (not subject to the tax).[4] The order imposes a moratorium, similar to the one approved by this Court in *Permian, supra*, 390 U.S. at 777–781, on the filing of producer rate

[3] Separate pricing according to vintage was approved in *Permian, supra*, 390 U.S. at 795–799.

[4] The base rates, as summarized in the Commission's opinion (C.A. App. 592), are as follows:

(1) For Contracts Dated Prior to October 1, 1968:
Onshore.....22.375¢
Offshore.....21.375¢
(2) For Contracts Dated On or After October 1, 1968:
Onshore.....26.0¢
Offshore.....26.0¢

The rates for pre-1968 contracts would increase automatically by 0.5¢ on October 1, 1973; the rates for post-1968 contracts would increase automatically by 1.0¢ on October 1, 1974 (*ibid.*).

increases above the applicable area rates (*id.* at 651–652).[5]

The Commission also established two incentive programs designed to stimulate exploration and to encourage new dedications of gas to the interstate market. First, each producer will be entitled to a credit of one cent toward the reduction of its total refund obligation for each additional Mcf of gas dedicated to the interstate market between August 1, 1971, and October 1, 1977 (*id.* at 592, 654, 666–667). Second, the base area ceiling rates for "flowing" gas (*i.e.*, gas delivered under pre-1968 contracts) will be increased in three stages when area producers as a group have newly dedicated to the interstate market specified amounts of gas reserves prior to October 1, 1977 (*id.* at 648–649).[6]

In addition, the Commission reduced from $375 million to $150 million the existing refund obligations

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[5] The moratorium extends to 1976 for pre-1968 contracts, and to 1977 for post-1968 contracts (*id.* at 651–652). The Commission's order provides, however, that a producer may apply for a waiver of the moratorium or seek an amendment to the rate structure where such relief can be justified in light of Opinion No. 598 and the accompanying order (*id.* at 661).

[6] Ceiling prices on contracts dated prior to October 1, 1968, will be increased as follows: (a) 0.5 cents per Mcf when 7.5 Tcf (trillion cubic feet) of new gas reserves are committed to interstate commerce; (b) an additional 0.5 cents per Mcf when new dedications reach the level of 11.25 Tcf; (c) an additional 0.5 cents per Mcf when new dedications amount to 15 Tcf (C.A. App. 649). Any new commitments by a producer will first be applied to the reduction of any outstanding refund obligations; only after all its refund obligations have been satisfied or eliminated will the producer's new dedications count toward the contingent escalation levels for the area (*id.* at 649, 658).

that had originally been imposed on area producers in *SoLa I* (*id.* at 652–654). It also established minimum pipeline rates for the transportation of certain liquid and liquefiable hydrocarbons (*id.* at 650–651, 660–661).

The elements of the Commission's order were part of a settlement offer that had broad but not unanimous support among the parties to the proceeding.[7] Although the Commission gave weight to the breadth of the proposal's support,[8] it adopted its terms only after it considered each aspect of the proposal on its merits in light of the evidence (*id.* at 594, 601).

On September 9, 1971, the Commission issued Opinion No. 598–A and an accompanying order clarifying its earlier opinion and order and denying rehearing (*id.* at 866–885).

4. THE DECISION BELOW

The court of appeals upheld the Commission's orders against a variety of attacks. It held, first (Pet. App. 20–23),[9] that the Commission could properly adopt,

[7] The Commission stated that "the proposal is supported by the overwhelming majority of consumer, pipeline, and producer interests" (*id.* at 589). These included 87 gas distribution companies serving about 20 million customers; all the interstate pipelines purchasing gas from the Southern Louisiana area; and 46 natural gas producers, accounting for 80 percent of the area's gas production (*ibid.*).

[8] "[I]ts wide support helps to provide stability in prices in the area and relieve the administrative burdens of the Commission, and to reduce the probabilities of future litigation" (*id.* at 601).

[9] "Pet. App." refers to the separately bound appendix to the petition in No. 73–437. "Pet. Supp. App." refers to the separately bound supplement to that appendix.

on the basis of an independent consideration of its merits, a rejected settlement offer that had wide support among the affected parties. The Commission "was conscious of its role" (*id.* at 21); it independently found that the plan would result in just and reasonable rates for the area.

The court rejected each of the other attacks upon the merits of the order. (1) Some parties challenged the ceiling rate for "new" gas (*i.e.*, gas delivered under post-1968 contracts) as inadequate to generate capital for future exploration. The court, however, approved the Commission's cost-based methodology and concluded that the rate for new gas "clearly falls within the 'zone of reasonableness' latitude which Courts must grant to FPC action" (*id.* at 35).[10]

(2) The contingent escalations of the price of flowing gas were challenged on several grounds. The court held (*id.* at 32–34) that the Commission could properly

[10] The Commission had concluded that there was a range of reasonable costs that was supported by the evidence in the record; the base rate for new gas was within the range of prices that could be supported by those costs and "at the appropriate level which will elicit exploratory and developmental effort in Southern Louisiana" (C.A. App. 642). Though it was unable to quantify the precise amount of the new supplies that would be elicited as a result of the rate it selected, the Commission concluded that the relationship between price and supply is a positive one (*id.* at 620, 623). As the court of appeals put it (Pet. App. 38): "As to defining the rate to supply relationship, FPC said in effect that 'we know that it's positive, but we can't say just how positive.' FPC has to be no more prescient." Since the base rate for new gas "clearly falls within the range of cost estimates which the evidence discloses," it was not necessary for the Commission "to make what would be a necessarily speculative quantification of non-cost elements" (*id.* at 39).

make the rate for flowing gas reflect part of the cost burden of stimulating new exploration and development. "[W]e cannot ignore FPC's determination that the extra earnings to be acquired through income for flowing gas at the increased rate would generate additional, and needed, internal capital available for expenditure in the search for new gas reserves" (*id.* at 32). Moreover, though it is delivered under a pre-1968 contract, flowing gas may spring from the same well as gas delivered under a later contract (*id.* at 34).

Some parties complained that some producers would be benefited more than others by the contingent escalations, and that the escalations would discourage new entrants into the industry because they would not have any pre–1968 contracts to which the escalations would apply. The court held (*id.* at 50) that "an administrative choice is not to be rejected merely because one party may get icing on his cake while another gets only cake." As for the new entrant, "we fail to see why he would be in the least bit dissuaded from committing new reserves at 26¢/Mcf by the fact that it might allow some of his competitors to raise their 22.375¢/Mcf flowing gas price by a half-penny" (*id.* at 51).

(3) With respect to the refund credit feature of the order, the court recognized (*id.* at 47), as had the Commission (C.A. App. 600–601),[11] that the producers who had collected the highest rates in the past or who had not yet discharged their previously adjudicated refund obligations would benefit the most from the

[11] The Commission explained that "no [area-wide] scheme can be free of some inequities" (C.A. App. 601).

system. It held, however, that the overall effect of the Commission's order would be to stimulate greater exploration; "we refuse to tamper with an overall program which effectively exploits [the] relationship" between rate and supply, so long as all the producers "get *some* cake" (Pet. App. 45; emphasis in original).[12]

(4) The court also upheld the Commission's moratorium on new filings of rate increases above the area ceiling (*id.* at 51–52), its minimum pipeline prices for transporting hydrocarbons (*id.* at 57), and its determination of producers' royalty obligations as an element of the costs of service (*id.* at 55–56).

DISCUSSION

We believe the decision below is correct. We agree with petitioners, however, that the court's upholding of the refund credit and contingent escalation aspects of the Commission's order is inconsistent with a recent decision of the Court of Appeals for the District of Columbia Circuit, and that the case presents important issues concerning the Federal Power Commission's regulatory authority under the Natural Gas Act adequately to regulate sales by natural gas producers in a time of critical gas supply shortage. We accordingly suggest that it would be appropriate for the Court to grant the petitions and set the cases for oral argument.

1. All three petitioners contend that the refund

[12] The court also held that the Commission's reduction of the total refund obligations (see pp. 7–8, *supra*) was not foreclosed by the court's prior affirmance of *SoLa I*, and that the amount chosen was supported by the evidence (Pet. App. 40–45). It rejected contentions that the refund reduction was improper because it benefited some producers more than others (*id.* at 45).

credits and contingent price escalations established by Order No. 598 are unduly discriminatory, anticompetitive, and contrary to the provisions of the Natural Gas Act (Mobil Pet. 20–26; PSC Pet. 11–14; MDG Pet. 11–13, 17–18, 24–25).[13] In our view, the court of appeals properly rejected these claims. While the order may result in greater financial benefit to some producers, no area rate scheme, affecting all the producers in the area, can be wholly free of such disparities. The total effect of Order No. 598 is just and reasonable, and is not unduly discriminatory. Moreover, as the Commission concluded, the order is likely to attract, rather than discourage, new entrants and to promote, rather than dampen, competition in the industry (C.A. App. 629).

The Court of Appeals for the District of Columbia Circuit, however, has reached inconsistent conclusions with respect to the nearly identical features of the Commission's rate order for the Texas Gulf Coast producing area. *Texas Gulf Coast Area Natural Gas Rate Cases,* Nos. 71–1828, *et al.,* decided August 24, 1973, pending on petitions for writs of certiorari, Nos. 73–966, 73–967, 73–968, and 73–969. The Commission in that case had relied in part on its decision in this case to support its determination that the refund credits and contingent escalations were proper. The court of appeals set aside the order and remanded the case, because it concluded that the Commission

[13] "Mobil Pet." refers to the petition of Mobil Oil Corporation, No. 73–437; "PSC Pet." refers to the petition of the Public Service Commission of the State of New York, No. 73–457; "MDG Pet." refers to the petition of the Municipal Distributors Group, No. 73–464.

had not adequately explained (*i.e.*, quantified) the relationship between the incentives and the expected increase in supply (Pet. Supp. App. 53–55). The court of appeals in the present case, by contrast, recognized that quantification of the rate-supply relationship is "impossible" (Pet. App. 36) and held that the Act does not require it (see note 10, *supra*).

The court in *Texas Gulf Coast* stated, contrary to the conclusions of the court of appeals in this case, that the refund credit and contingent escalation features "may impinge on competition" by permitting old producers "to outbid new entrants due to the expected differential in total returns" (Pet. Supp. App. 63). "[W]e do not think that the supply shortage or need for capital rationale have been responsive to the asserted problems of discrimination and anti-competitive effects" (*id.* at 69). The court acknowledged that "[t]here may be a sound explanation for the system adopted," but it held that "we have not been offered one by the Commission" (*id.* at 68).

Since the Commission had referred to its decision in the present case, however, it is evident that the D.C. Circuit in effect rejected the same explanations that the court below considered sufficient. It accordingly recognized that its approach was inconsistent with that of the court of appeals in the present case (*id.* at 72).

In our petition for a writ of certiorari in the *Texas Gulf Coast* case (No. 73–968), we expressed our view that the conflict between the two courts of appeals

would not be resolved in a remand of that case to the Commission. We stated (p. 20):

> There is nothing for the Commission to say that has not already been said; its findings and reasoning, accepted by the Fifth Circuit in *Placid*, were disapproved by the court below in this case, and no purpose would be served by reiterating views that have already been considered and rejected. In order to satisfy the court below, the Commission would, as a practical matter, have no alternative but to abandon its rate structure.

We therefore believe that the conflict is ripe for resolution by this Court.

2. With respect to petitioners' remaining contentions,[14] the decision below does not conflict with that of any other court of appeals, and we believe the court correctly answered each of the arguments. We do not, however, urge the Court to limit the writs, because the elements of the rate order are interdependent. The validity of each element may depend in part on the validity and effect of the remaining elements; the

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[14] These are: (1) that the Commission improperly reduced existing refund obligations (PSC Pet. 14–17; MDG Pet. 13–17, 18–24); (2) that the base ceiling rates do not provide an adequate rate of return or allowance for exploration and development (Mobil Pet. 26–28); (3) that the moratorium on new rate increase filings is invalid (Mobil Pet. 28–29); (4) that the Commission's minimum price for transporting hydrocarbons is not supported by substantial evidence (Mobil Pet. 30–31); (5) that the Commission failed to provide a sufficient allowance for increased royalty obligations (Mobil Pet. 31–34); and (6) that the Commission improperly adopted the terms of a rejected settlement proposal (PSC Pet. 17–20).

Court's consideration of petitioners' contentions with respect to the refund credit and contingent escalation features may well be illuminated by consideration of the remaining contentions as well.

CONCLUSION

The petitions for writs of certiorari should be granted. Although the Federal Power Commission and several other parties have filed petitions for writs of certiorari in the *Texas Gulf Coast* case, a decision in the present case may resolve many of the questions presented in those petitions. For that reason, and because of the urgency of the current gas supply shortage, we urge the Court to grant certiorari in the present case and set it down for oral argument this Term rather than waiting to consolidate the two cases. If, after a decision in the present case, any remaining issues in *Texas Gulf Coast* require separate consideration, the petitions in that case could be granted and the case could be heard next Term.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General

LEO E. FORQUER,
General Counsel,
Federal Power Commission.

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